PERSONAL NEWSLETTER FROM THE BOYCHUK KNOBLAUCH FINANCIAL GROUP

PERSPECTIVE

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BOYCHUK KNOBLAUCH
FINANCIAL GROUP

To Our Clients:

As we find ourselves at the halfway mark of another year that has required continued endurance, there is hope that we are emerging from the worst of the pandemic. With the return of summer, our perseverance and resilience should be rewarded.

We would like to thank those of you who have introduced our team to friends and family. We remain available to provide a fresh opinion on an existing portfolio or advice relating to a new situation.

Wishing you many days of well-deserved relaxation this summer.

— Tyson and Dean

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CUTTING THROUGH THE NOISE

Noise, according to Nobel-prize winning economist Daniel Kahneman, is the unwanted variability that can cloud judgment and impact decision making. We can make different decisions when influenced by noise, such as when we are upset, tired or hungry compared to calm, rested or well-fed. Kahneman shows how doctors give drastically different diagnoses to identical patients as a result of noise. Most of the time, we are unaware of the noise and neglect it. Yet, by reducing it we can make better decisions.[1]

Nowhere is the impact of noise more evident than in investing. Modern behavioural economists have shown that noise can significantly change the way we make investing decisions.

In the excitement of rising markets, there has been a particular amount of noise to distract investors. Strong markets give confidence to some investors to take on greater risks. We are also living in a period of technological change and new innovation can make it difficult to assess risks, as expectations are largely driven by hope and uncertainty about the future.

In May, the cryptocurrency Dogecoin, a joke named after a "doge meme,"[2] became the fourth most valuable digital currency after gaining over 14,000 percent to start the year. This was a surprise to its cofounder, who reportedly created it in "a few hours" and sold his holdings in 2015.[3] Similarly, SPAC issuances have surged, prompting regulators to warn investors not to be "lured into participating in a risky investment."[4] SPACs sell shares with the objective of buying a private company and taking it public. They are known as "blank cheque" companies for a reason: they have no operating business and often no stated acquisition targets.

As investors, we must cut through the short-term noise as we invest for the longer term. It's easy to get caught up in the excitement — we'd all like to ride the next superstar investment to financial freedom. We may also feel that we aren't successful investors unless we are in the middle of the action. Yet, when there is too much enthusiasm for what appears to be a good thing, it can prove unsustainable — the warning signs sometimes only apparent to the astute.

What is the opposite of noise? According to Kahneman, it is discipline. Some of the most successful investors are able to ignore the noise when they make portfolio decisions. They follow the specific rules established to control risk within a portfolio. While such an approach may not produce the results that make overnight headlines, it provides a good litmus test to avoid being carried away by the enthusiasm of the moment. In a world of noise, discipline can be one of the investor's greatest assets.

Today's investing landscape looks particularly different than one year ago: certain economies have reopened and we are seeing strengthening commodities prices and increasing inflationary pressures. The changing times are precisely when trusted advisors can provide thoughtful evaluation and scrutiny in investment choices, shifting gears where necessary to position for change.

Let's enjoy the market advances, but don't be led astray by the noise. Maintain discipline and continue to look forward — and use our resources to help you achieve your investment goals.

1. Kahneman, Sibony, Sunstein (2021), Noise: A Flaw in Human Judgment. Harper Collins; 2. Meme: an amusing captioned picture/video widely spread online through social media; en.wikipedia.org/wiki/Doge_(meme); 3. markets.businessinsider.com/currencies/news/dogecoin-price-rally-eclipses-xrp-4th-largest-crypto-doge-2021-5-1030391242; 4. Special Purpose Acquisition Company; sec.gov/oiea/investor-alerts-and-bulletins/celebrity-involvement-spacs-investor-alert

FOUR WAYS THE FEDERAL BUDGET MAY AFFECT YOU

This past spring, the federal government released its first budget in more than two years. It was largely focused on supporting economic recovery as we continue the fight against Covid-19. It offered extensions to various Covid-19-related benefits, resulting in a record deficit and significantly higher projected debt for the foreseeable future. While there were no changes to personal or corporate income tax rates, here are four ways you may be impacted:*

Seniors — If you are age 75 years or older as of June, 2022, a one-time Old Age Security (OAS) payment of $500 will be made by this August. For this same age group, monthly OAS payments will be increased by 10 percent, beginning in July, 2022. If you aren't in need of these funds, consider investing them.

Investors — Over the next five years, $8.8 billion has been pledged to support green initiatives, including the intent to raise $5 billion through a green bond launch planned for the 2021-2022 fiscal year. Proceeds will be used to finance a variety of green projects. According to the budget, these government-backed bonds may support more mature investors who are "looking for a green portfolio but also need to manage their investment risk."[1] With a continuing focus on responsible investing, have you considered this as part of your own portfolio?

High-Net-Worth Spenders — If you're lucky enough to be purchasing a luxury vehicle in the near future, consider making a purchase by Dec. 31, 2021. As of January 1, 2022, sales of luxury cars and personal aircraft with a retail sales price of over $100,000, as well as boats over $250,000, will incur a new tax. It will be calculated at the lesser of 20 percent of the value above those thresholds, or 10 percent of the full value of the vehicle.

Business Owners — If you operate a Canadian-controlled private corporation, you will now be able to purchase up to $1.5 million of certain capital assets and fully expense them in the year they become available for use. This includes eligible assets purchased on or after April 19, 2021 and before 2024. There may be tax benefits achieved by immediately expensing assets versus capitalizing a purchase; however, seek the advice of a tax professional relating to your situation.

For greater detail on all initiatives proposed, see the Government of Canada website: budget.gc.ca/2021/home-accueil-en.html

1. Budget 2021: A Recovery Plan for Jobs, Growth and Resilience, Government of Canada, page 166. *At the time of writing, the budget proposals had not been passed into law.

INFLATION: HOW HAS PURCHASING POWER CHANGED?

In 1987, Brian Mulroney was prime minister, the new "loonie" was starting to line our pockets, "La Bamba" was the top 100 single in Canada and Gretzky and Lemieux would lead us to a win against the Soviet Union in the Canada Cup hockey finals. Back then, a Big Mac would put you back around two dollars.

Fast forward to today and that same Big Mac costs over three times the price at around $6.77. During that time, average family income has only risen by 91.8 percent* and according to the Bank of Canada, the Consumer Price Index (CPI), its measure of inflation, has increased by 107 percent, which represents a year-over-year increase of just 2.2 percent.

Today, one of the most pressing questions in financial circles is whether inflation will become a problem, or if current inflationary pressures are temporary in nature as the central banks would like us to believe. If we were to consider the increasing price of commodities, which is feeding into consumer prices, as well as rising food prices, many would argue that the CPI is not very telling. Those who believe inflation may become a greater force cite a variety of factors that signal a potential shift: significant government stimulus, aging demographics in low-cost manufacturing geographies and empowered labour that puts upward pressure on wages and prices. Others suggest that inflation won't be able to maintain its recent pace after struggling to climb for many years, attributing it to pandemic-depressed prices.

Changes in the Prices of Select Items: 1987 & 2021[2]

	1987	2021	Change
Cdn. Family Income (Avg.)[3]	$37,118	$71,200 (2019)	+91.8%
Cdn. House (Avg.)[4]	$129,702	$716,000	+452.0%
Flat Screen Television[5]	$1,599 (32")	$750 (55")	-53.1%
Top Apple Computer[6]	$9,150	$7,400	-19.1%
Microwave[5]	$580 (680W)	$140 (1100W)	-75.9%
Bottle of Dom Perignon[7]	$85.25	$267.95	+214.3%
Big Mac Hamburger[8]	$2.05	$6.77	+230.2%
University Tuition[3]	$1,137	$6,580	+478.7%
Consumer Price Index[9]	67.5	139.6	+106.8%
S&P/TSX Composite Index[10]	3,729.30	20,035.30	+437.2%

1. CANSIM Table 027-0015; 2.1988 data: Report on Business Magazine, April 2012, pg. 13; 3. Statistics Canada T-1110019101; Undergrad tuition https://www150.statcan.gc.ca/n1/daily-quotidien/200921/dq200921b-eng.htm; 4. CREA; 5. Sony HD TV at bestbuy.ca; 6. MacPro on apple.ca; 7. LCBO; 8. economist.com; 9. https://www.bankofcanada.ca/rates/related/inflation-calculator/ for March 1987 and 2021; 10. Close on June 7.

Regardless of the path forward, how has purchasing power really changed? The chart above shows the prices for select items back in 1987 and today. While prices for many things have gone up, tech amenities have become more affordable: consider that TVs are not only larger and thinner, but cheaper! The good news is that since 1987, investors have seen the S&P/TSX Composite Index gain over 430 percent, an annualized rate of around 5 percent (not including dividends reinvested). If history is any indicator, equity markets continue to be a great way to grow funds for the future.

*Average family income is slightly higher when adjusted for inflation.

PREPARING FOR A WEALTH TRANSFER

With over one trillion dollars of inheritances expected to be passed along over the next decade, taking action to preserve wealth across generations has never been more important.[1] Does your estate plan protect this wealth transfer? Here are some considerations:

Preventing Your Estate from Being Contested

It isn't uncommon for disputes to arise during the estate settlement process, especially for families with complex dynamics. In some cases, these disputes can escalate to litigation. While court battles are not only time consuming and stressful, they can also end up being very costly, which can significantly erode family wealth. Perhaps worst of all, they can tear families apart. The reasons are many, including outdated documentation, poorly drafted documents, poorly chosen executor(s) and lack of communication about estate plans with beneficiaries.

There may be ways to minimize this risk. Communicating with heirs about your intentions while you are alive can help to prevent surprises. Importantly, estate documents should be drafted using a reputable professional and should include specific instructions to eliminate doubt. Documents should be reviewed and updated as circumstances require. Care should also be taken when choosing an executor(s), as poor actions by executors can lead to litigation.

Helping Beneficiaries Manage a Wealth Transfer

In some cases, beneficiaries may need support to manage wealth. Young beneficiaries or those with disabilities may not be financially responsible; spouses may need help managing assets such as investments or a business. Beneficiaries may also need to be protected against potential current or future creditors, such as business partners, customers or former spouses.

One of the more common tools used to support beneficiaries is a testamentary trust to hold and manage assets for their benefit. This can help to limit access and manage assets by specifying the timing and amount of distributions to be made.

Accounting for Divorce or Blended Family Dynamics

The transfer of family wealth may need to be protected to account for a complex family structure. In some cases, the way in which assets are currently structured may not be meeting your objectives. For instance, having assets jointly held in a current relationship may unintentionally put children from a previous marriage at risk. An unintended division of assets may also occur if a current spouse becomes a primary beneficiary, when assets were intended for children from a previous marriage. In some provinces, a new marriage can potentially revoke an existing will and the instructions leaving assets to children from a previous marriage would be invalidated. As such, the advice of a lawyer who understands complex family structures can ensure that assets are passed along as intended.

If you have the desire to leave a lasting legacy, planning ahead can help to protect family wealth. Given our familiarity with your financial position, we can act as a resource. As always, seek the support of tax and legal professionals for your particular situation.

1. financialpost.com/personal-finance/retirement/canadian-inheritances-could-hit-1-trillion-over-the-next-decade-and-both-bequeathers-and-beneficiaries-need-to-be-ready

AVOID PENALTIES: REVIEW YOUR TFSA

Over recent years, the Canada Revenue Agency (CRA) has continued its review of the Tax-Free Savings Account (TFSA), auditing holders it believes to have over-contributed. If an individual exceeds their TFSA contribution limit for the first time, they are sent a warning letter and/or *Form RC243-P, Proposed TFSA Return*. This form assesses an amount of penalty tax due. If the excess TFSA amount has been removed prior to receiving the letter, generally no further action is required. As such, if you may have inadvertently over-contributed, it may be worthwhile to review your TFSA to make corrections before a penalty tax is assessed. Here are two mistakes that are often made:

TFSA funds are withdrawn and recontributed within the same year. TFSA withdrawals made in a certain year do not create contribution room until the following calendar year. If you do not have contribution room available in a particular year, any recontributed funds would be considered to be an over-contribution for that year.

TFSA funds are withdrawn and transferred to another TFSA at a different financial institution. This can be done without penalty, but it must be done through a direct transfer that is completed by the financial institution. If funds were instead withdrawn from one TFSA as cash and moved to another TFSA held at a different institution, this would be considered to be a withdrawal followed by a contribution. In this case, contribution room for the withdrawal would not be created until the next calendar year.

What is the penalty? A TFSA penalty is assessed at one percent of the over-contribution amount per month until the excess amount has been removed from the TFSA (or additional contribution room becomes available). For example, an indirect transfer of $5,000 from one TFSA to another that is considered an over-contribution would be assessed a penalty of $50 per month, or $600 per year. Over time, these penalties can add up.

How to determine contribution room: TFSA contribution room information is available on your CRA online account: "My Account". You can also contact the CRA to request a *TFSA Room Statement* or *TFSA Transaction Summary* showing contribution and withdrawal information.

Reminder: The 2021 TFSA dollar contribution amount is $6,000, bringing the eligible lifetime contribution amount to $75,500. Have you fully contributed?

THE FOUR PERCENT RULE REVISITED

How much can I spend in retirement so that I don't outlast my money? This is one of the more common questions we hear as we help clients to plan ahead.

This question also spawned the birth of the "four percent rule," which has become a commonly-used guideline within financial planning circles. It is a simple way to think about retirement withdrawals. Adding all of your investments, you can withdraw four percent of the total during the first year of retirement. In subsequent years, you adjust this amount for inflation. This provides a good proxy for not outliving your money, assuming a 30-year retirement.

Where Did the Four Percent Rule Come From?

The "rule" has been around since 1994 when rocket-scientist-turned-financial-advisor Bill Bengen took on the task of determining a safe withdrawal rate to protect investors from running short of funds in retirement. Bengen's model assumed that there would be no severe market downturns and the investor would rely upon a predictable, steady stream of income. Here are some of his original findings:[1]

- The "absolutely safe" withdrawal rate based on historical market returns was three percent. A portfolio would never be fully drawn down in less than 50 years.
- A four percent withdrawal rate was considered safe as it never resulted in a portfolio being exhausted in less than 33 years.
- The "worst-case" for a 4.25 percent withdrawal rate was a portfolio that lasted 28 years.
- While the model was based on a 50/50 stock/bond portfolio, Bengen suggested allocating a greater proportion to equities, between 50 and 75 percent.

Of course, like most generalizations, Bengen's simple rule of thumb might not fit every investor's situation. After all, retirement spending isn't necessarily constant from year to year. Some retirees have greater expenditures earlier in retirement as they opt to enjoy their healthy years travelling the world or enjoying other costly pursuits; others may be confronted with high healthcare or caregiving expenditures as they age.

The rule was also based on a suggested portfolio composition and historical returns that were relevant in 1994. Things looked a lot different back then. Treasury yields hovered around 8 percent; today, they are closer to 2 percent. Historical inflation at that time was around 5.7 percent for the previous 25 years; today, the 25-year rate averages around 2.2 percent (see chart).

Chart: A Lot Has Changed Since 1994...

	1994	2021
10-Year Govt. of Canada Marketable Bonds Rate (A)	8.63%	1.90%
25-Year Historical Rate of Inflation (B)	5.7%	2.2%
5-Year Avg. Residential Mortgage Rate (C)	7.89%	3.26%
Cost of 1L Whole Milk (D)	$1.36	$1.51
Cost of Eggs (doz. lg.) (E)	$1.49	$3.77
Price of Gas (reg. unleaded)/L (F)	$0.52	$1.25

A: Bank of Canada; www150.statcan.gc.ca/n1/pub/11-210-x/2010000/t098-eng.htm (v122487); B: awealthofcommonsense.com/2020/10/what-if-the-4-rule-for-retirement-withdrawals-is-now-the-5-rule/; C: Bank of Canada; www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3410014501; D: fraserinstitute.org/sites/default/files/PerfectFoodinaPerfectMess.pdf; E: archive.macleans.ca/article/1994/1/24/the-cost-of-feeding-canada; D, E, F: www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1810000201; F: www150.statcan.gc.ca/n1/pub/57-601-x/2010004/t182-eng.htm

The Rule, Revisited for 2021

Given that much has changed over 27 years, you may wonder if the rule has also changed. According to Bengen — yes — and his conclusion may be surprising. He recently suggested that if he were to update the model, he would actually recommend a higher withdrawal rate: "5.25 or even 5.5 percent, which is going to enrage people even more because it's higher...but that's what history has demonstrated."[2]

Planning Ahead

Having this rule of thumb can be helpful to act as a general guide. However, one of our main roles is to support the planning process to account for your particular circumstances and to make course adjustments as life transpires. If your wealth plan is in need of an update or if you would like to discuss your retirement income plan in greater depth, please don't hesitate to call.

1,2. https://awealthofcommonsense.com/2020/10/what-if-the-4-rule-for-retirement-withdrawals-is-now-the-5-rule/

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